



OFFICE OF THE  
CITY AUDITOR

**A COMPLIANCE AUDIT OF THE CITY  
AND REDEVELOPMENT AGENCY INVESTMENT  
PROGRAMS FOR  
JANUARY AND FEBRUARY 1986**

A REPORT TO THE  
SAN JOSE  
CITY COUNCIL  
APRIL 1986

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## EXECUTIVE SUMMARY

Our review of investment transactions for the City and the Redevelopment Agency for January and February 1986 indicates that Finance has generally complied with Investment Policy requirements. Noncompliance continues in areas which require more in-depth staff work and legal assistance. These areas include evaluating dealer financial condition, executing formal dealer and safekeeping agreements and expediting delivery of transaction confirmations. Improvements in documentation and control procedures are occurring and will be monitored after implementation until Finance staff becomes familiar with the procedures. Appendix A contains an overview of the results of this bi-monthly review.

The City Auditor has developed a number of recommendations to enhance compliance with the City's Investment Policy and improve the City's investment program. Our review indicates that Finance is taking steps to comply with prior audit recommendations. Of the twenty-five recommendations contained in the Reviews of September, October, November, and December 1985 Investments:

- o Seven have been fully implemented,
- o Two are combined with other recommendations,
- o Five are implemented, but procedures need improvement, and
- o Eleven are in progress.

### BACKGROUND

In response to an August 5, 1985 Council Finance Committee request, the City Auditor has initiated a process for monthly reviews of investments for the City and the Redevelopment Agency. These reviews have resulted in twenty-five recommendations to improve the investment program. Finance is taking steps to implement the City Auditor's recommendations to correct the problems noted during the monthly reviews. Implementation of all recommendations is anticipated by July 1986. While implementation of the recommendations will improve the overall safety of the investment program, the inherent risk of investment activities cannot be eliminated.

Since the investment loss occurred in May 1984, the administration has improved the investment program substantially. By June 1984, speculative investment practices, including open reverse repurchase agreements, had ceased and practices emphasizing safety were in place. By October 1984, the City had: 1) implemented revised investment policies and procedures; 2) identified required revisions in the monthly investment report; 3) issued the first revised monthly investment report;

4) brought the average portfolio maturity nearly within three years; 5) completed extensive reconstruction and revision of cash flow information; 6) produced the first automated cash flow forecast; 7) initiated work to refine the cash flow forecast and 8) completed initial work to convert revenue and expenditure information into MONEymax-compatible format. By October 1985, the City had: 1) reached the three year average portfolio maturity goal; 2) prepared the investment policy for formal adoption by Council; 3) recruited and hired a Chief of Treasury with investment expertise; 4) implemented the MONEymax cash flow forecast module for the City portfolio; and 5) completed refinements in the investment report.

When the City Auditor began monthly reviews of investment transactions in September 1985, Finance was substantially complying with Policy rating, type and location requirements for issuers and instruments. These Policy provisions are designed to limit purchases to the safest types of investments. Exceptions to portfolio diversification requirements were occurring primarily due to inadequate procedures and documentation.

The deficiencies noted from the outset of these reviews were essentially twofold. First, inadequate procedures and documentation; 1) allowed inadvertent Policy exceptions to

occur 2) eroded safety provisions 3) prevented adequate management oversight of the investment program and 4) impeded third party review of investments. Second, delays in implementing Policy requirements for dealer and safekeeping agreements, and for evaluating and monitoring dealer financial condition, weakened the City's position in the event of bank or dealer failure.

As this report indicates the Administration has made substantial progress toward correcting the above deficiencies.

*IMPROVEMENTS NOTED IN MEETING  
POLICY REQUIREMENTS AND  
DOCUMENTING INVESTMENT TRANSACTIONS*

Our review of investment transactions for the City and the Redevelopment Agency for January and February 1986 indicates that Finance has generally complied with Investment Policy requirements. Noncompliance continues in areas which require more in-depth staff work and legal assistance. These areas include evaluating dealer financial condition, executing formal dealer and safekeeping agreements and expediting delivery of transaction confirmations. Improvements in documentation and control procedures are occurring and will be monitored after implementation until Finance staff becomes familiar with the procedures. Appendix A contains an overview of the results of this bi-monthly review.

Dealer Prequalification

The eleven dealers involved in investment transactions during January and February 1986 either report to the Market Report Division of the Federal Reserve or meet the Policy's Keefe, Bruyette and Woods rating requirements. All have acknowledged the City's investment policy. Treasury is still in the process of obtaining updated financial statements from all dealers. Treasury evaluation of dealer financial condition

will occur once evaluation procedures are finalized. A draft services agreement, which includes master repurchase provisions, is being reviewed by the City Attorney's Office. Finance has targeted May 1 for execution of agreements with dealers.

### Purchases

Of the transactions reviewed, purchases met Policy rating, type and location requirements for issuer and instruments. Repurchase agreements met Policy collateral requirements as well as Treasury's more recent internal guidelines requiring that collateral be set at 102% of the agreement's face value for agreements exceeding one day. The number of securities held as repurchase collateral were limited to no more than five for each agreement. Beginning in February, securities held as collateral for repurchase agreements and dealer identification, are entered in MONEYMAX and a mark-to-market report is generated.

In an earlier review, we requested that Finance seek clarification regarding the type of securities and maturity dates acceptable for collateral in repurchase agreements. The Private Sector Panel, in a meeting on March 21, 1986, recom-



mended that Finance implement procedures to limit securities accepted as repurchase collateral to the type of government securities authorized for purchase by the Policy. In addition, the procedures are to indicate a preference for securities with maturities of three years or less. No amendment to the Policy was required.

Procedures to document market condition and purchase strategy were implemented in December. This documentation requires further review as Treasury staff becomes more familiar with the process.

#### Sales

On February 13, 1986, Stripped Coupons and U.S. Treasury Notes with maturity dates exceeding Policy limits were sold from the City's portfolio. The City Auditor does not interpret the Policy to apply to purchases occurring prior to adoption of the Policy. However, the Department of Finance and the Internal Investment Committee have determined that all investments, regardless of purchase date, are subject to sale if they do not comply with current Policy provisions. Finance reported these exceptions in Exhibit D of the December 1985 Monthly Investment Reports. As determined by the Internal Investment Committee, these non-complying investments are

subject to on-going review for sale when market conditions are favorable. Finance cites the planned elimination of all investments violating Policy maturity limits as the primary rationale for the February sales. They plan to sell "non-complying" instruments and make shorter term investments.

The instruments sold were book-entry U.S. Treasury Notes and bearer-form U.S. Treasury Bond Stripped Coupons. The coupons are "stripped" from two Treasury Bond series, one maturing 11-15-2001 with an expected yield of 15.75% and another maturing 2-15-1992 with an expected yield of 14.58%. A bearer-form U.S. Treasury Bond consists of the body of the Bond (Corpus) and attached interest coupons (Strips) for each six-month interest payment due for the life of the Bond. The owner of the Bond may sell one or more of the coupons, at a discount from face value, in order to meet current cash needs. The purchaser of the coupon(s), in this case the City, can then redeem them when the interest payment is due.

The specific investments sold are listed below:

INVESTMENTS SOLD ON FEBRUARY 13, 1986

<u>LINE NO</u>	<u>DESCRIPTION</u>	<u>MATURITY DATE</u>	<u>INVESTMENT COST</u>	<u>YIELD 365 DAY</u>	<u>ESTIMATED GAIN ON SALE</u>
12545	USTN	7/15/90	5,014,779.27	14.521	382,880.32
12878	USTN	7/15/90	5,023,550.00	15.158	376,637.65
15144	TB/N Stripped Coupons	5/15/91	200,523.42	15.511	20,674.94
15145	TB/N Stripped Coupons	11/15/91	190,430.63	15.578	20,027.88
15152	TB/N Stripped Coupons	2/15/92	1,535,795.80	16.851	203,635.09
15146	TB/N Stripped Coupons	5/15/92	180,845.78	15.601	19,143.23
15147	TB/N Stripped Coupons	11/15/92	171,743.40	15.796	19,199.31
15148	TB/N Stripped Coupons	5/15/93	161,512.17	16.320	19,995.07
15149	TB/N Stripped Coupons	11/15/93	153,310.09	16.503	19,839.81

On the same day these instruments were sold, the City purchased \$10,000,000 in U.S. Treasury Bills with an anticipated yield of 7.5%. The highest anticipated yield on any investment during January and February was 7.9%. Finance furnished the January 14, 1986 Minutes of the Internal Investment Committee meeting (Appendix C) as prior authorization for the sales.

Additional documentation included Treasury's Call Sheet, a bid sheet and published articles on market condition. We have suggested that, in the future, all pertinent sales documentation be maintained with the Daily Cash Flow and that Treasury use a form initialed by the Treasurer like the worksheets used for purchases. Documentation of sales will be monitored as Treasury staff becomes more familiar with the procedures.

#### Portfolio Mix

Our review indicated that Finance complied with Policy percentage limits for categories of investments and for single issuers of uninsured uncollateralized investments. However, the Policy's 10% single-issuer restriction for all investments other than government issues is exceeded if repurchase agreements are regarded as issues of the dealer.

The Investment Policy states that credit risk will be mitigated:

*"by diversifying the investment portfolio so that the failure of any one issuer or backer will not place an undue financial burden on the City."*

The Policy additionally states that:

*"No more than 10% of the total portfolio shall be invested in the issuances of any single institution other than securities issued by the U.S. Government and its affiliated agencies."*

Finance did not concur with the City Auditor's interpretation that repurchase agreements should be considered an "issue" of the dealer and, thus, subject to the 10% restriction.

On March 21, 1986, the Private Sector Panel agreed with the City Auditor that repurchase agreements should be considered when computing the total invested with a single issuer. Finance requested a means for occasional investment of unanticipated cash in large repurchase agreements without violating Policy provisions. After deliberation, the Panel recommended that the Policy be amended to allow the occasional use of overnight repurchase agreements to exceed the 10% single-issuer restriction. This allows Finance to utilize overnight repurchase agreements for temporary investment of large amounts of cash not anticipated in the cash flow forecast.

#### Safekeeping

Formal safekeeping agreements, currently in draft form, are targeted for execution with the safekeeping agents in early May. Currently, there is an unresolved controversy as to whether or not a Bank Trust Department is an independent third party for the purpose of safekeeping securities if the Bank's Trading Department acts as dealer on the transaction. Pending further clarification of State law and Government Accounting

Standards Board (GASB) requirements, Finance has ceased entering into repurchase agreements with the safekeeping agent for each portfolio.

On March 21, 1986, Finance recommended that the Policy be amended to prohibit placing investments with safekeeping banks. The Private Sector Panel did not endorse this amendment. The Panel recommended deferring such a Policy amendment until the legal necessity becomes clear.

In earlier reviews, we found that safekeeping receipts were not being reconciled with Treasury confirmation documents. Based on this review, the Accounting Division is now reconciling safekeeping receipts to Accounting's copy of Treasury's confirmation document.

#### Other Procedures/Controls

Treasury has implemented some improvements in the documentation of cash flow information. However, the accuracy of the cash flow forecast and the usefulness of documentation to third party review is still limited. The overview investment procedures are updated and MONEymax instructions are in draft form. Detailed procedures, or desk manuals, will be

completed as time permits. Finance is preparing Policy revisions pursuant to the March 21, 1986 meeting of the Private Sector Panel.

Currently the Policy requires that written confirmation for release of securities be transmitted within 24 hours of verbal notification. We have also requested that written confirmation of purchases be subject to the same time frame. The Private Sector Panel approved a Finance recommendation to revise the Policy to allow five working days from settlement to mailing of confirmations documents. Treasury confirmations are not mailed until all required Finance signatures are obtained. Based on transactions reviewed, in January and February, the average number of working days from settlement date to the date of the last signature on the confirmation was 7 days for sales and 3.6 days for purchases.

Treasury plans to implement prenumbered confirmation forms and is looking into automated generation of confirmations through MONEYMAX. Procedures to document telephone instructions for release of funds and securities were properly followed. Accounting is date stamping safekeeping receipts and debit and credit advices.

In an earlier review, we recommended that Finance separate the functions of receiving investment income from placing investments. As an alternative to reorganization, the Treasurer, rather than the Treasury Assistant, signs revenue vouchers for investment income. This procedure requires further evaluation.

#### CONCLUSION

Our review of January and February 1986 investment transactions did not reveal any new areas of non-compliance. Finance is taking steps to implement prior audit recommendations to correct the problems noted during previous reviews. Implementation of all recommendations is anticipated by July 1986. While implementation of the recommendations will improve the overall safety of the investment program, the inherent risk of investment activities cannot be eliminated.

The adequacy of Finance cash management and investment strategies will be addressed in the investment program audit scheduled to commence July 1986. It is anticipated that improved documentation of buy and sell decisions will facilitate a third party review.



*FOLLOW-UP ON PRIOR  
RECOMMENDATIONS*

The City Auditor has developed a number of recommendations to enhance compliance with the City's Investment Policy and improve the City's investment program. Our review indicates that Finance is taking steps to comply with prior audit recommendations. Of the twenty-five recommendations contained in the Reviews of September, October, November, and December 1985 Investments:

- o Seven have been fully implemented,
- o Two are combined with other recommendations,
- o Five are implemented, but procedures need improvement, and
- o Eleven are in progress.

Following is an implementation status report for prior recommendations. An overview chart showing the implementation status of prior recommendations is contained in Appendix B.

## September 1985 Investment Review

### Recommendation #1:

Treasury staff utilize MONEymax in managing the portfolio and making investment decisions by: running a portfolio profile daily or on each day when purchases, sales or maturities occur; and using the portfolio report in making investment decisions. (Priority 1)

### Status

Implemented.

### Recommendation #2:

Treasury staff insure that entry into MONEymax is timely and accurate by: entering the transaction data on the date that the transaction occurs; running machine numbered, logged and dated batch reports for all entries; and reviewing batch reports for accuracy. (Priority 1)

### Status:

Implemented.

Recommendation #3:

Finance enhance staff's ability to utilize MONEYMAX by: providing comprehensive training for employees in the use of MONEYMAX; and preparing a simplified instructions manual on the use of MONEYMAX for Finance employees. (Priority 2).

Status:

Treasury provides on-the-job training for staff and Wismer is readily available by telephone to answer questions and resolve problems. Treasury has scheduled formal training for the MONEYMAX Gateway Module on March 28, 1986.

The MONEYMAX instruction manual is being finalized and will be ready for use by end of March, 1986.

Further follow-up is required.

Recommendation #4:

Treasury staff advise Finance management of portfolio status on a timely basis by distributing a copy of the portfolio profile report in Recommendation #1 to the Treasurer, Chief of Accounting and the Finance Director. (Priority 1)

Status:

Implemented.

Recommendation #5:

Treasury staff prepare revenue vouchers for maturities, sales and interest payments on the date funds are deposited or payment is received. (Priority 1)

STATUS:

Implemented.

Recommendation #6:

Treasury staff maintain documentation to verify information used each day in making investment decisions, including the portfolio profile report and all cash flow information. (Priority 2)

Status:

Treasury has improved procedures. MONEymax Cash Flow Forecasts are retained in a chronological binder. Daily Cash Flow sheets now include the run date of the MONEymax Cash Flow Forecast and the date and source of interim information used to determine investible funds.

Further follow-up is required.

Recommendation #7:

Finance complete procedures regarding prequalification of financial institutions. (Priority 1)

Status:

This recommendation is now included in Recommendation #3 of the October Investment Review.

Recommendation #8:

Treasury document reasons for sales. (Priority 2)

Status:

On February 13, 1986, Treasury sold U.S. Treasury Notes and Stripped Coupons. Treasury states that the securities were sold mainly because their maturity dates were beyond the 3-year maturity limit prescribed by the City Investment Policy. These were the first sales to occur since our recommendation to maintain documentation. Documentation should improve as Treasury staff becomes familiar with the procedures.

Further follow-up required.

Recommendation #9:

Accounting complete improvements in reconciliation procedures. (Priority 2)

Status:

The intent of this recommendation is now included in Recommendations 7 and 12 in the review of October transactions.

October 1985 Investment Review

Recommendation #1:

Finance comply with Policy requirements to execute formal safekeeping agreements with the City and Redevelopment Agency's Custodial Agents to assure that the City's interest in securities is adequately perfected. (Priority 1)

Status

A draft safekeeping agreement is still undergoing legal review. Finance expects that formal safekeeping agreements will be executed by May 1, 1986.

Further follow-up is required.

Recommendation #2:

Treasury staff comply with Policy requirements to maintain collateral at 100% of the repurchase agreement's face value, marked-to-market daily, or sufficiently in excess of the agreement's face value. (Priority 1)

Status

Since late February, Treasury has monitored repurchase collateral through the MONEymax system. Treasury prepares a daily Mark-to-Market Report to compare the market value of collateral to the face value of the repurchase agreement. In addition, for agreements exceeding one working day, the Treasurer has instructed staff to maintain collateral at a minimum of 102% of the repurchase agreement's face value.

Implemented.

Recommendation #3:

Finance comply with Policy requirements to establish procedures to evaluate and monitor dealer financial condition and execute formal master repurchase agreements and services agreements with dealers. (Priority 1)

Status:

Treasury has completed draft procedures for evaluating dealer financial statements. Treasury plans to complete evaluations by the middle of April 1986. In addition, Treasury has received RFP responses and expects to execute a new Banking Services Agreement by May 1, 1986.

Further follow-up is required.

Recommendation #4:

Treasury establish guidelines for repurchase agreements which 1) allow substitution of securities only on an exception basis, and 2) limit the number of securities used as collateral. Treasury document reasons for exceptions to the guidelines. (Priority 1)

Status

The revised overview procedures establish guidelines for substitution of securities held as collateral in a repurchase agreement. The guidelines require Treasury to document



circumstances related to substitution. The guideline limiting the number of securities used as collateral is not documented. However, our review indicates that the number is being held to five or less.

Further follow-up is required.

Recommendations #5:

Finance obtain clarification from the Private Sector Investment Committee regarding the issues of repurchase agreement collateral, issuer percentages, and financial institution qualifications. (Priority 2)

Status

We requested that Finance pose the following questions to the Private Sector Panel:

1. Should securities accepted as collateral for a repurchase agreement be restricted to:
  - a. Types of government securities approved for purchase?

b. The three year maturity limit  
for government securities?

2. Should repurchase agreements with  
dealers be considered when figuring  
the 10% limit on investments with a  
single issuer?

These issues were presented to the Private Sector Panel  
on March 21, 1986.

The Panel recommended that securities accepted as  
collateral for repurchase agreements be limited to the types of  
government securities authorized for purchase in the Policy.  
The Panel further recommended that Finance observe the Policy's  
three-year maturity limit for repurchase collateral whenever  
practical. Thus allowing Finance to exercise discretion  
depending on market conditions at the time of purchase. These  
provisions will be incorporated in Finance procedures and no  
Policy revision is required.

The Panel concurred that Policy intent is to limit  
investments with a single issuer to no more than 10% of the

total portfolio. However, they agreed to amend the Policy to allow overnight repurchase agreements to exceed the 10% limit.

Further follow-up is required.

Recommendation #6:

Finance include in its Monthly Investment Report all investments which do not comply with Policy provisions. Finance should indicate which investments are subject to on-going review for potential sale. (Priority 2)

Status

In December, Finance initiated a new practice of reporting investments purchased prior to the April 2, 1984 Investment Policy which do not comply with current Policy provisions. This report omitted a number of investments which do not comply with Policy rating, type and location requirements. The January 1986 Investment Report includes the investments omitted in the December report.

Implemented.

Recommendation #7:

Accounting ensure that safekeeping receipts are promptly received and reconciled. (Priority 1)

Status

Implemented.

Recommendation #8:

Treasury establish data entry standards to ensure the accuracy of MONEYMAX entry, including adequate issuer identification. (Priority 1)

Status:

The Treasurer has issued a memorandum instructing staff in the use of abbreviation codes to identify dealers. MONEYMAX procedures are being finalized and will be ready for use by end of March.

Further follow-up is needed.

Recommendation #9:

Treasury enter the dealer's name and securities held as collateral for repurchase agreements into the MONEymax system.  
(Priority 1)

Status:

Entry is now taking place. Further follow-up is required as Treasury staff becomes familiar with the procedure.

Recommendation #10:

Treasury document daily investment strategy and purchase decisions. (Priority 2)

Status:

Further follow-up is required as Treasury staff becomes more familiar with the new procedures.

Recommendation #11:

Treasury segregate the functions of investing funds and receiving investment income. (Priority 1)

Status:

Treasury has implemented an alternative procedure. The Chief of Treasury or designee not involved in investment activities approves investment-related revenue vouchers.

Further follow-up is required.

Recommendation #12:

Finance establish additional procedures to ensure that controls are functioning and written verification of purchases and sales is complete and timely. Specifically, procedures need to be established to 1) monitor compliance with Policy provisions regarding release of funds or securities 2) provide for 24 hour preparation and mailing of confirmations 3) implement pre-numbered and controlled confirmation documents and 4) date stamp and reconcile dealer, safekeeping, debit and credit advices as received. (Priority 2)

Status:

The Control Log for wire transfer of funds has been properly initialed since November 1985. Finance will propose an amendment to the Investment Policy to allow five working days for transmittal of confirmations. Implementation of

pre-numbered confirmation documents is targeted for June 1, 1986 in order that automation of forms through MONEYMAX can be explored. Accounting is now date stamping all receipts and advices.

Further follow-up is required.

#### November-December 1985 Investment Review

##### Recommendation #1:

Finance obtain a legal opinion to determine requirements for an independent third party custodian for securities involved in City investments. (Priority 2)

##### Status

Finance has temporarily ceased executing repurchase agreements with the banks who serve as the safekeeping agents for the City and the Redevelopment Agency portfolios. The issue of third party custodians may be addressed in the legal review of the proposed safekeeping agreements.

Further follow-up is required.

Recommendation #2:

Finance incorporate a clause in the proposed City-initiated dealer agreements to supersede any prior service or master repurchase agreements with the dealer. (Priority 2)

Status

Finance will include the recommended clause in the master repurchase agreement now under review by legal counsel.

Further follow-up is required.

Recommendation #3:

Finance document its Policy interpretations. (Priority 2)

Status

The Treasury Assistant will document the requested policy interpretations pursuant to the Private Sector Panel meeting on March 21, 1986.

Further follow-up is required.



Recommendation #4:

Finance prepare a compilation and analysis of State and Federal laws applicable to the investment program. (Priority 2)

Status

Finance will request legal assistance to compile the recommended reference library.

Further follow-up is required.

CITY OF SAN JOSE - MEMORANDUM

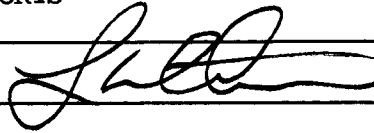
TO: Honorable Mayor and City Council

FROM: Edward G. Schilling  
Director of Finance

SUBJECT: RESPONSE TO THE JANUARY AND  
FEBRUARY INVESTMENT PROGRAM  
COMPLIANCE REPORTS

DATE: April 10, 1986

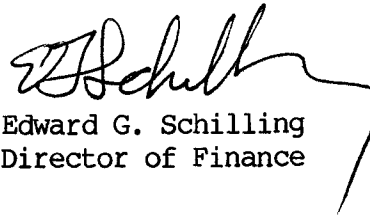
APPROVED



DATE

The Finance Department concurs with the observations of the City Auditor in the subject compliance review. We will be forwarding an updated informational report on the projected completion dates of major compliance related projects in the near future.

Respectfully submitted,



Edward G. Schilling  
Director of Finance

EGS:jb

RECEIVED

APR 10 1986

CITY AUDITOR

# APPENDIX A

## SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF JANUARY 1986 AND FEBRUARY 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions <u>Meet Criteria?</u>	
	<u>January 1986</u>	<u>February 1986</u>
<b>A. PREQUALIFICATION OF DEALERS</b>		
1. Is the Dealer (1) on the list of Government Security Dealers Reporting to the Market Reports Division of Federal Reserve, or does the dealer meet the required Keefe, Bruyette and Woods rating?	YES	YES
2. Has the Dealer or Bank filed an acknowledgement of receipt and review of the City's Investment Policy with Treasury?	YES	YES
3. Have Financial Statements been filed with Treasury?	NO	NO
4. Do the Financial Statements include a Balance Sheet and a Profit and Loss Statement?	NO	NO
5. Are the Financial Statements current?	NO	NO
6. Has Treasury reviewed the Financial Statements?	NO	NO
7. Has a Services Agreement been executed?	NO	NO

(1) Includes banks and savings and loans acting as dealers. Treasury accepts a Keefe, Bruyette and Woods rating of "B", or "C" for selected major California banks, in lieu of primary dealer status for banks and savings and loans.

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## SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF JANUARY 1986 AND FEBRUARY 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>January 1986</u>	<u>February 1986</u>
<b>B. PROVISIONS APPLYING TO ALL PURCHASES</b>		
1. Purchase is of an approved instrument?	YES	YES
2. Purchase Maturity is within policy limits for instrument?	YES	YES
3. Wire Transfer of funds initiated by employee other than employee initiating investment?	YES	YES
4. Wire Transfer of funds carried out according to the terms of preformatted Wire Transfer letter?	YES	YES
<b>C. PORTFOLIO MIX</b>		
1. Is within Policy limits for category of instruments?	YES	YES
2. Total with a single issuer, other than government issues:		
a) Is within 10% of total portfolio;	NO*	NO*
b) For uninsured-uncollateralized issues, is within 5% of total portfolio?	YES	YES
<b>D. TIME DEPOSITS - BANKS AND SAVINGS AND LOANS</b>		
1. Bank or savings and loan is located in San Jose area (Santa Clara County)?	YES	NONE

\*Based on Repurchase Agreements

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## SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF JANUARY 1986 AND FEBRUARY 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>January 1986</u>	<u>February 1986</u>
2. If not San Jose area, is it a minority bank?	NONE	NONE
3. Is a Contract for Public Funds Deposit on file?	YES	NONE
4. Is a Waiver for Collateralization on file (for insured portion)?	YES	NONE
5. For uninsured portion (over \$100,000), is the deposit with a bank or savings and loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected California bank" (Bank of America or Wells Fargo) rated "C" or better?	NONE	NONE
E. U. S. GOVERNMENT AGENCY ISSUES		
1. Is issue by one of the following: o Federal Farm Credit Bank; o Federal Home Loan Bank; or o Federal National Mortgage Association?	YES	YES
F. REPURCHASE AGREEMENTS		
1. Collateral is U.S. Treasury or Government Agency issue approved for purchase by Policy?	YES	YES
2. If overnight, collateral is equal to 100% of the repurchase agreement's face value?	YES	YES
3. If other than overnight, collateral is marked-to-market on a daily basis and maintained equal to 100% of the repurchase agreement's face value; or is sufficiently in excess of the repurchase agreements face value?	YES	YES

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## SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF JANUARY 1986 AND FEBRUARY 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>January 1986</u>	<u>February 1986</u>
G. REVERSE REPURCHASE	NONE	NONE
H. BANKER'S ACCEPTANCES		
1. Is the issuer a bank or savings and loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected California bank" (Bank of America or Wells Fargo) rated "C" or better?	YES	YES
I. NEGOTIABLE CERTIFICATES OF DEPOSIT		
1. Is the issuer a bank or savings and loan with a Keefe, Bruyette and Woods rating of "A" or better.	YES	NONE
J. COMMERCIAL PAPER		
1. Is this a domestic corporation?	YES	YES
2. Does this institution have the highest rating by Moody's or Standard and Poor's?	YES	YES
3. Does this institution have total assets of \$500,000,000 or more?	YES	YES
4. Does this institution have an "A" rating or higher on its own indebtedness other than its commercial paper?	YES	YES

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<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	January	February
	<u>1986</u>	<u>1986</u>
K. SAFEKEEPING-TREASURY PROCEDURES		
1. Person initiating release of securities is not same person initiating sale?	NONE	YES
2. Written confirmation for release of City-owned securities was transmitted to Safekeeper within 24 hours of telephone instructions.	NONE	NO
L. SAFEKEEPING - SECURITY/COLLATERAL HELD		
1. Collateral held by a Safekeeping Agent under the terms of a Safekeeping Agreement with the City?	NO	NO
2. For securities serving as collateral for a repurchase agreement which are not held by a Safekeeping Agent, are the securities held by a third party custodian with a Safekeeping Agreement with the City?	NONE	NONE
3. For uninsured/collateralized Time Deposits in a savings and loan, is collateral held by the Federal Home Loan Bank?	NONE	NONE

# APPENDIX A

## SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF JANUARY 1986 AND FEBRUARY 1986 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>January 1986</u>	<u>February 1986</u>
4. For uninsured/collateralized Time Deposits in a bank, is collateral held in the City's name in:		
a) The issuing banks' trust department, provided the bank has a Safekeeping Agreement with the City, or	NONE	NONE
b) In the San Francisco Federal Reserve Bank?	NONE	NONE
M. REPORTING		
1. Exceptions reported to Finance Committee?	YES	YES
<u>OTHER AREAS</u>		
1. Was sale necessary to meet cash needs?	NONE	NO



APPENDIX B  
SUMMARY OF IMPLEMENTATION STATUS  
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>REVIEW OF SEPTEMBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u>  Treasury staff utilize MONEYMAX in managing the portfolio and making investment decisions by: running a portfolio profile daily or on each day when purchases, sales or maturities occur; and using the portfolio profile report in making investment decisions. (Priority 1)	Implemented
<u>Recommendation #2</u>  Treasury staff insure that entry into MONEYMAX is timely and accurate by: entering transaction data on the date that the transaction occurs; running machine numbered, logged and dated batch reports for all entries; and reviewing batch reports for accuracy. (Priority 1)	Implemented
<u>Recommendation #3</u>  Finance enhance staff's ability to utilize MONEYMAX by: providing comprehensive training for employees in the use of MONEYMAX; and preparing a simplified instruction manual on the use of MONEYMAX for Finance employees. (Priority 2)	In-house training is on-going. Training on MONEYMAX (Gateway Training) is scheduled on 3-28-86. MONEYMAX instructions are targeted for completion April 1.
<u>Recommendation #4</u>  Treasury staff advise Finance management of portfolio status on a timely basis by distributing a copy of the portfolio profile report in Recommendation #1 to the Treasurer, Chief of Accounting and the Finance Director. (Priority 1)	Implemented

APPENDIX B  
SUMMARY OF IMPLEMENTATION STATUS  
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #5</u>  Treasury staff prepare revenue vouchers for maturities, sales and interest payments on the date funds are deposited or payment is received. (Priority 1)	Implemented.
<u>Recommendation #6</u>  Treasury staff maintain documentation to verify information used each day in making investment decisions, including the portfolio profile report and all cash flow information. (Priority 2)	Implemented. Requires further monitoring.
<u>Recommendation #7</u>  Finance complete procedures regarding prequalification of financial institutions.	Included in Recommendation #3 of the October Investment Review.
<u>Recommendation #8</u>  Treasury document reasons for sales.	Documentation for February sales needed improvement. Further monitoring required.

APPENDIX B  
SUMMARY OF IMPLEMENTATION STATUS  
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #9</u>	
Accounting complete improvements in reconciliation procedures.	This recommendation is now included in Recommendation #7 and 12 of the the October Investment Review.
<u>REVIEW OF OCTOBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u>	
Finance comply with Policy requirements to execute formal safekeeping agreements with the City and Redevelopment Agency's Custodial Agents to assure that the City's interest in securities is adequately perfected. (Priority 1)	Draft agreement undergoing legal review. Execution of safekeeping agreements is anticipated by May 1. Further follow-up required.
<u>Recommendation #2</u>	
Treasury staff comply with Policy requirements to maintain collateral at 100% of the repurchase agreement's face value, marked-to-market value daily, or sufficiently in excess of the agreement's face value. (Priority 1)	Implemented.

APPENDIX B  
SUMMARY OF IMPLEMENTATION STATUS  
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #3</u>  Finance comply with Policy requirements to establish procedures to evaluate and monitor dealer financial condition and execute formal master repurchase agreements and services agreements with dealers. (Priority 1)	Evaluation procedures are in draft form. Evaluations will be completed when procedures are in place. City Attorney's Office is reviewing a draft dealer service agreement which includes master repurchase provisions. Finance has targeted May 1, 1986 for execution of agreements.
<u>Recommendation #4</u>  Treasury establish guidelines for repurchase agreements which 1) allow substitution of securities only on an exception basis, and 2) limit the number of securities used as collateral. Treasury document reasons for exceptions to the guidelines. (Priority 1)	Investment procedures include guidelines on authorizing substitution of securities, and documenting circumstances for such substitution. The procedures still need to be revised to include guideline on the number of securities used as collateral.
<u>Recommendation #5</u>  Finance obtain clarification from the Private Sector Investment Committee regarding the issues of repurchase agreement collateral, issuer percentages, and financial institution qualifications. (Priority 2)	At a meeting on March 21, 1986, the Private Sector Panel 1) limited collateral to those types of securities approved for purchases and 2) allowed collateral maturity dates to exceed the three-year limits. The Policy will be amended to clarify rating requirements.

APPENDIX B  
SUMMARY OF IMPLEMENTATION STATUS  
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #6</u>  Finance include in its Monthly Investment Report all investments which do not comply with Policy provisions. Finance should indicate which investments are subject to on-going review for potential sale. (Priority 2)	Implemented.
<u>Recommendation #7</u>  Accounting ensure that safe-keeping receipts are promptly received and reconciled. (Priority 1)	Implemented.
<u>Recommendation #8</u>  Treasury establish data entry standards to ensure the accuracy of MONEYMAX entry, including adequate issuer identification. (Priority 1)	Partially implemented. Treasury issued a memo instructing use of abbreviation codes to identify dealers. MONEYMAX instructions manual is being finalized.
<u>Recommendation #9</u>  Treasury enter the dealer's name and securities held as collateral for repurchase agreements into the MONEYMAX system. (Priority 1)	New procedures require further follow-up.

APPENDIX B  
SUMMARY OF IMPLEMENTATION STATUS  
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #10</u>  Treasury document daily investment strategy and purchase decisions. (Priority 2)	New procedures require further follow-up.
<u>Recommendation #11</u>  Treasury segregate the functions of investing funds and receiving investment income. (Priority 1)	Alternative procedures implemented. The Chief of the Treasury or designee not involved in investment activities approves revenue vouchers. Further follow-up required.
<u>Recommendation #12</u>  Finance establish additional procedures to ensure that controls are functioning and written verification of purchases and sales is complete and timely. Specifically, procedures need to be established to 1) monitor compliance with Policy provisions regarding release of funds or securities 2) provide for 24 hour preparation and mailing of confirmations 3) implement pre-numbered and controlled confirmation documents and 4) date stamp and reconcile dealer, safekeeping, debit and credit advices as received. (Priority 2)	Partially implemented. The Control Log for wire transfer of funds has been properly initialed since November 1985. Finance plans to amend the Investment Policy to allow five working days for transmittal of confirmations. Implementation of pre-numbered confirmations is targeted for July 1, 1986. Accounting is now date stamping all receipts and advices.

APPENDIX B  
SUMMARY OF IMPLEMENTATION STATUS  
FOR PRIOR RECOMMENDATIONS

REVIEW OF NOVEMBER-DECEMBER 1985 INVESTMENTS

<u>Recommendation</u>	<u>Status</u>
<p><u>Recommendation #1:</u></p> <p>Finance obtain a legal opinion to determine requirements for an independent third party custodian for securities involved in City investments. (Priority 2)</p>	<p>Finance has stopped executing repurchase agreements with the bank which safekeeps that portfolio's securities. The issue of third party custodian may be addressed in the legal review of the proposed safekeeping agreement.</p>
<p><u>Recommendation #2:</u></p> <p>Finance incorporate a clause in the proposed City-initiated dealer agreements to supersede any prior service or master repurchase agreements with the dealer. (Priority 2)</p>	<p>Finance will include the recommended clause in the master repurchase agreement now under review by legal counsel.</p>
<p><u>Recommendation #3:</u></p> <p>Finance document its Policy interpretations. (Priority 2)</p>	<p>Finance will complete this documentation after the March 21 Private Sector Panel Meeting.</p>
<p><u>Recommendation #4:</u></p> <p>Finance prepare a compilation and analysis of State and Federal laws applicable to the investment program. (Priority 2)</p>	<p>Finance will request legal assistance to comply with this recommendation.</p>

MINUTES  
Internal Investment Committee  
January 14, 1986

Members: Edward Schilling, Chairman  
Gerald Newfarmer  
Susan George  
Deborah Kelly  
Emily Harrison  
Theodore Biagini

1. December Minutes

The minutes of the December 18, 1985, meeting were reviewed and adopted with one correction noted by Susan George: the position of Budget Director should be corrected to read Deputy City Manager in the section pertaining to the membership of the Internal Investment Committee.

2. November 1985 Investment Reports

The investment reports for November 1985 were discussed. The exception which occurred at the end of the month was also reviewed.

3. Banking Services RFP

The Chief of Treasury reviewed the time frame for the review and release of the banking services RFP. It was expected that the new term of agreement for the City's account would begin May 1, 1986. The RFP for the Redevelopment Agency would be processed immediately after the City's agreement was in place.

4. Contractual Arrangements with Banks and Dealers

The Chief of Treasury reviewed the time frame for the completion of signed agreements for safekeeping and dealer services (including master repurchase agreements). Barring unforeseen circumstances, it was expected that signed agreements could be on file by May 1, 1986.

5. Market Overview by Chief of Treasury

The Chief of Treasury presented a market overview which covered the recent slides in the bond and stock markets. It was not yet apparent that a fundamental change in interest rates had occurred so strategy remained focused within the 3 to 6 month maturity range. Some additional discussion was devoted to the factors introducing uncertainty into the forecast beyond 6 months.



Internal Investment Committee  
January 14, 1986

6. Additional Matters of Concern to the Committee

The Chief of Treasury asked the Committee for feedback about the process for future sales of non-complying instruments in the portfolios. She indicated that the time appeared to be about right for selling (as described in the Market Overview section of the November investment report), but felt that a problem would arise if the Investment Policy were interpreted too literally. For example, if one of the authorized dealers which specialize in commercial paper wished to purchase something other than commercial paper, e.g. the City's stripped coupons, would the City's policy prohibit this transaction? The Chief of Treasury went on to ask if it would be permissible to sell an NCD back to the non-qualifying institution if there were little or no interest expressed by the dealer community. The Committee concluded that since the policy was intended to address credit concerns and since the City would not deliver the security sold until payment was received, those transactions would not present credit risks. Therefore, both types of transactions described would be: (1) allowable, and, (2) reportable as technical exceptions only.



Edward G. Schilling, Chair  
Internal Investment Committee

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